DOW THEORY LETTERS INC.

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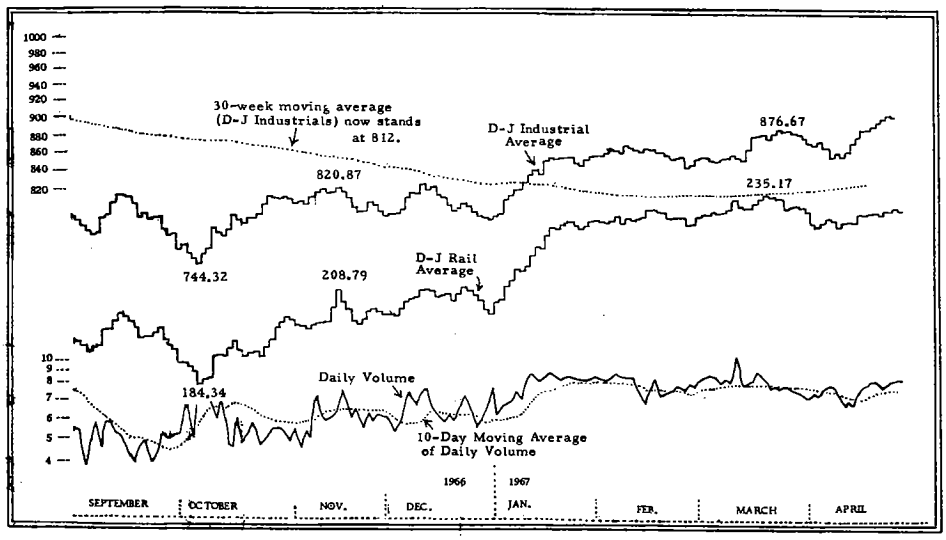
THE MARKET: The question I have been receiving from a number of subscribers is, "Do you still think this is a primary bear market?" In my opinion, we are witnessing nothing more than a major correction within a continuing primary bear market. Robert Rhea stated repeatedly that secondaries within primary bull (or bear) markets tend to retrace one to two thirds of the ground previously lost. At the recent (March) peak, the D-J Rail Average had retraced 57% of the 87.38 points lost during 1966. At last week's high, Industrials had retraced approximately 60% of their own 1966 losses.

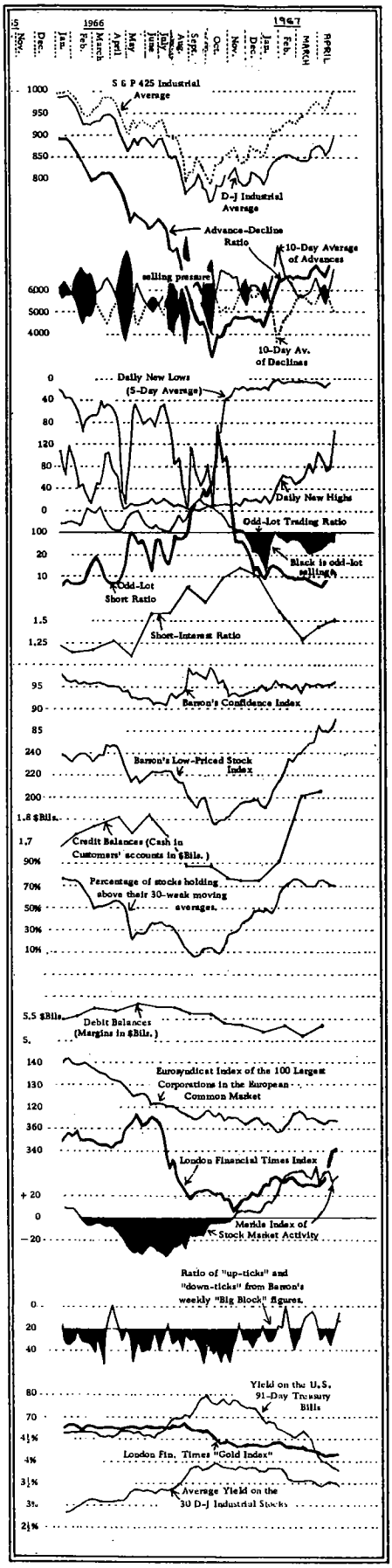
I have written at length of the implications of an Industrial rise above the 869.74 or halfway level of the entire 1966 decline. For six days during March, Industrials climbed above the 869.74 level, only to plunge below that level during late March. Then the most recent rally again took Industrials above the halfway level, and this time Industrials bettered their March 23 recovery peak of 876.67.

Technically, according to the 50% Principle, the Dow is now entitled to the additional strength of having successively navigated above the halfway mark of the previous major (1966) decline. Although this Principle is now operating on the bullish side of the ledger, it is also operating within the framework of a primary bear trend. If this were a primary bull market, I would unhesitatingly state that the 50% Principle was pointing to an ultimate approach and bettering of the 1966 all-time high. But because I believe we are in a primary bear market, I am prompted to treat the 50% Principle much more gingerly at this time.

Near-term, it is notable that the Rails Average has not yet confirmed the new recovery highs established by the Industrial Average. In fact, it has been almost six weeks since the last recovery high in Rails (recorded at 235.17 on March 17). Within a bear market it may be stated that the longer the elapsed time between a non-confirmation, the more dangerous the underpinnings of the market. It is also worth noting that this is the first time since October, 1966, that the Rail Average has failed either to lead Industrials to new highs or at least to confirm a new Industrial high within a matter of a few days.

It is now most important for Rails to confirm by bettering the 235.17 March peak. Persistant refusal to confirm could spell the end of the entire advance. If Rails ultimately refuse to confirm, history will record the termination of the advance as March 17. That is the date of the last confirmed highs on both Averages. Remember, according to




S & P 425 Industrial Average
D-J Industrial Average
Advance-Decline Ratio
10-Day Average of Advances
selling pressure
10-Day Av. of Declines
Daily New Lows (5-Day Average)
Daily New Highs
Odd-Lot Trading Ratio
Black is odd-lot selling
Odd-Lot Short Ratio
Short-Interest Ratio
Barron's Confidence Index
Barron's Low-Priced Stock Index
Credit Balances (Cash in Customers' accounts in $Bils.)
Percentage of stocks holding above their 30-week moving averages.
Debit Balances (Margins in $Bils.)
Eurosyndicat Index of the 100 Largest Corporations in the European Common Market
London Financial Times Index
Merkle Index of Stock Market Activity
Ratio of "up-ticks" and "down-ticks" from Barron's weekly "Big Block" figures.
Yield on the U.S. 91-Day Treasury Bills
London Fin. Times "Gold Index"
Average Yield on the 30 D-J Industrial Stocks

time-tested Dow Theory tenets, a movement of one Average unconfirmed by the other is meaningless for prediction purposes, and is more apt than not to be deceptive.

In the last Letter I wrote that I believed the peak of strength had been seen for this advance. I am still of this opinion. I base this statement on the sluggishness of the Rail Average, the drop-off in rate of rise of the advance-decline ratio, but most of all on a peak (three weeks ago) and severe drop in certain upside-downside volume totals which I have been keeping for over five years. I am not at liberty to publish the last mentioned indicator, but suffice it to say that this indicator is composed of differentials of long-term upside and downside N.Y.S.E. volume totals. In the past, whenever this indicator touched a peak (following a sustained advance) and then turned decisively down, the peak of strength of the advance had passed. Based on my studies of this long-term indicator, I would guess that technical deterioration should be evident from now on during this market advance. I believe the sluggishness of the Rails constitutes the first visible sign of such technical deterioration.

OFF THE TOP OF MY HEAD: (1) I believe that investors are still not seeing Vietnam in perspective. It is the "biggest factor" around, politically, socially, economically. Supply routes from Russia through China have now been agreed upon. This suggests to me that the war from the standpoint of Hanoi is to be stepped up. It means that U.S. casualties will increase. It means that new pressures will come from the U.S. to increase U.S. commitments. Already, the word is that General Westmoreland has asked for 600,000 troops in Vietnam. Haiphong has been bombed for the first time.

(2) I believe that the Communists have written off negotiations with LBJ. The President is too "committed" in Vietnam. He has so much at stake that I do not believe the Communists feel that they can get "a good deal" in a negotiation with the present Administration. I feel that the Communists must believe that it will pay them to sit with the rising tide of anti-Vietnam sentiment on the part of the American public in the hopes that LBJ will be defeated in 1968. Then they would negotiate with a new U.S. President who was in "fresh," with no reputation on the line and no pressures as to "loss of face."

(3) There is no doubt that the rising anti-Vietnam sentiment on the part of the U.S. public is giving heart to the Communists. The recent San Francisco and New York protest rallies showed one thing—it is now "respectable" to go out and march in an anti-Vietnam rally. This was not true even a year ago. If the war lasts through 1968, this issue will tower over all other election issues (unless the economy collapses).

(4) The Communists believe that time is working on their side. The bigger the war, the greater the possibility of international monetary trouble or U.S. economic trouble. Any such event would put even greater pressure on the U.S. to end the war—and fast.

(5) It should be remembered that this is the first "big-money" war fought during the lifetime of this generation without price controls. If the latter (because of inflation) becomes necessary, stock market and consumer confidence could collapse. This too would aid the Communist effort, so again the time factor militates against Communist desire to negotiate.

(6) The republican "big money" would like Nixon in '68. But they would also like to win. The intellectual Eastern Republicans would like to run Rockefeller. They know that the East does not take Romney or Reagan seriously. Nixon is a "loser," and he is poison to the liberals. But if it looks as though the Democrats are in trouble in '68 via an economic downturn and a continuation of the war, I believe the Republicans could conceivably take a chance on Nixon with perhaps Percy (as V.P.) thrown in as something for the liberals.

(7) The important negro vote is turning against Vietnam en masse. Both liberal and extremist elements in the negro political spectrum are opposed to the war. The negro vote is liable to go solidly in protest to any liberal Republican. This would mean men of the Rockefeller, Percy ilk.

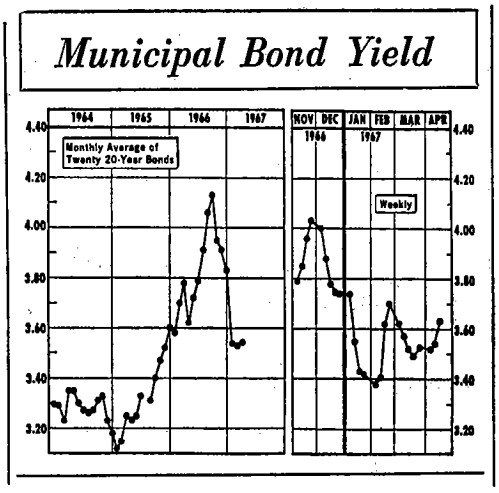
(8) One of the big objections to Rockefeller last time was the feeling that the conservative mid-West would not accept a divorced man. But with farm income down sharply this year, the farm vote is likely to go to anyone running against LBJ. This again would be a big boost for Rockefeller's chances (how about this for a wild East-West Republican ticket, Rockefeller and Reagan. It could happen).

Another phenomenon worth watching from now on is the trend of bond yields. Since tight money hit the economy and the stock market hard last year, it behooves us to scrutinize the trend of bond yields again at this point. Although the Federal Reserve was successful in flooding the market with money, thereby driving short-term interest rates down, it is important to note that long-term bonds have all along remained sticky on the downside (see 40-Bond Average on the full page chart in this Letter). Another excellent yield indicator is the chart of the Municipal Bond Yields as published every Monday in the Wall Street Journal. This chart shows that interest rates on Municipals (which are mostly long-term) have been building higher bases since early this year. For the past four weeks Municipal yields have been climbing steadily higher with the latest average yield at 3.63%. My guess would be that when Municipal yields close above the February peak of 3.72% talk of "a trend to higher interest rates" will start creeping into the news again. A renewed tightening of interest rates could stop this market dead in its tracks.

My friend Eliot Janeway noted some time ago that tightening interest rate trends usually come in two consecutive sweeps. Historically, the second sweep is more severe than the first. I believe, due to an impending business pickup and coming huge Federal deficit financings, the seeds of the second upward sweep in interest rates has now begun. Keep your eyes on it; it could be the biggest financial story of 1967.

GOLD: After the six Common Market finance ministers met in Munich last week the French Minister Debre announced, "France, Germany, Belgium and Luxembourg now are speaking the same language." In other words, on gold and monetary affairs the members of the Common Market are beginning to see eye to eye. Since the combined members of the Common Market are now creditors of the U.S. and since the Common Market now owns more gold than the U.S., this is a situation of great importance.

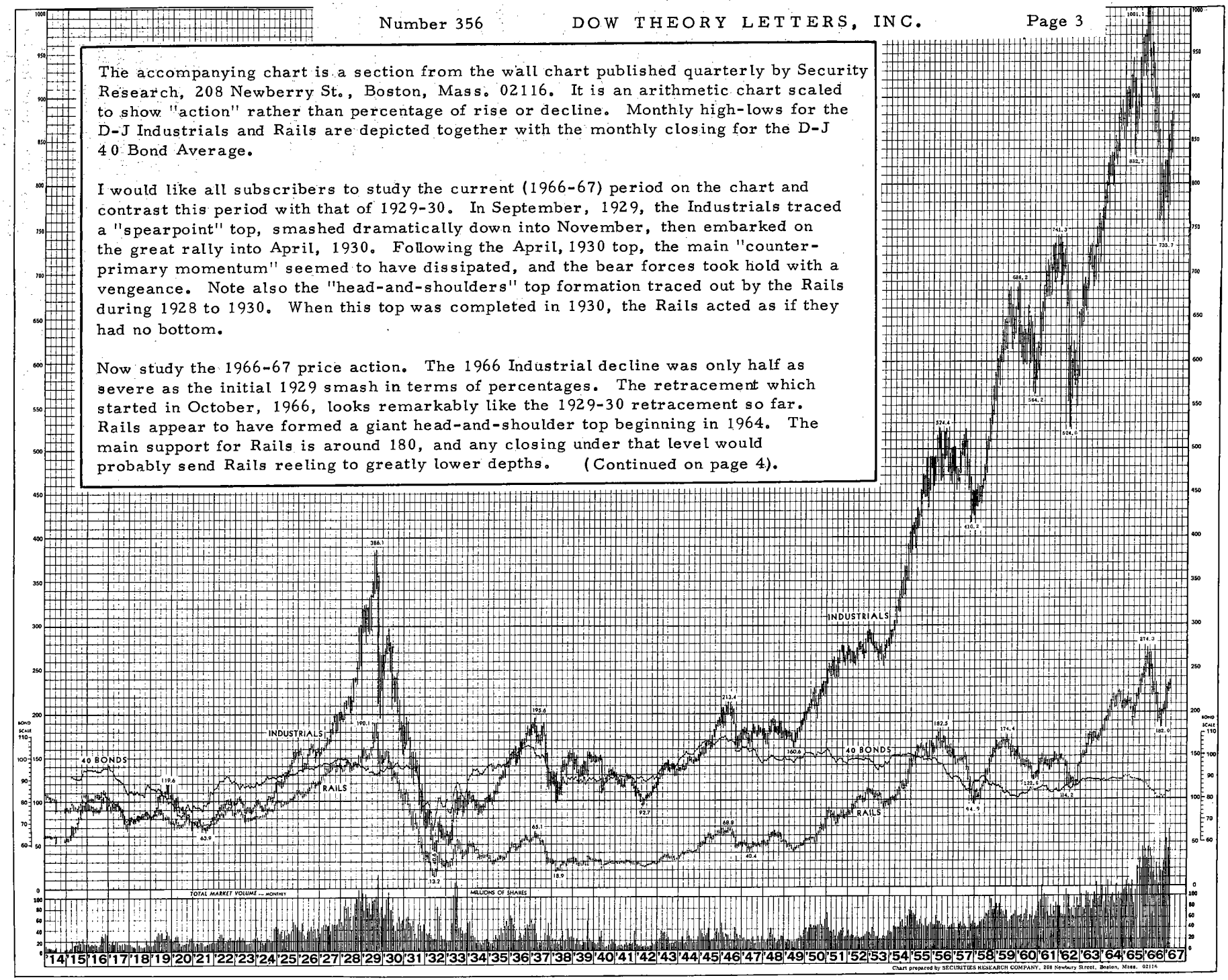
Commenting upon the Debre statement, the Christian Science Monitor's London financial correspondent said, "The opinion is growing here that the U.S. Treasury now might be wise to begin rethinking its monetary policies and philosophy to obviate any possible future danger of its isolation from world economic thought."



The accompanying chart is a section from the wall chart published quarterly by Security Research, 208 Newberry St., Boston, Mass. 02116. It is an arithmetic chart scaled to show "action" rather than percentage of rise or decline. Monthly high-lows for the D-J Industrials and Rails are depicted together with the monthly closing for the D-J 40 Bond Average.

I would like all subscribers to study the current (1966-67) period on the chart and contrast this period with that of 1929-30. In September, 1929, the Industrials traced a "spearpoint" top, smashed dramatically down into November, then embarked on the great rally into April, 1930. Following the April, 1930 top, the main "counter-primary momentum" seemed to have dissipated, and the bear forces took hold with a vengeance. Note also the "head-and-shoulders" top formation traced out by the Rails during 1928 to 1930. When this top was completed in 1930, the Rails acted as if they had no bottom.

Now study the 1966-67 price action. The 1966 Industrial decline was only half as severe as the initial 1929 smash in terms of percentages. The retracement which started in October, 1966, looks remarkably like the 1929-30 retracement so far. Rails appear to have formed a giant head-and-shoulder top beginning in 1964. The main support for Rails is around 180, and any closing under that level would probably send Rails reeling to greatly lower depths. (Continued on page 4).


INDUSTRIALS
RAILS
40 BONDS
TOTAL MARKET VOLUME — MONTHLY
MILLIONS OF SHARES
Chart prepared by SECURITIES RESEARCH COMPANY, 208 Newbury Street, Boston, Mass. 02116

During the conference the French proposed that the U.S. and British eliminate their balance-of-payments deficits. They also proposed an upgrading of the voting strength of the Common Market in the IMF, thus putting the Common Market on an equal level with the U.S.

Behind this is France's intention of eliminating the pound and the dollar as reserve currencies. France states that it is tired of seeing the U.S. "export" its deficit, thus allowing U.S. business to buy up foreign assets with paper dollars. France wants the U.S. to be subject to the same monetary disciplines as the rest of Europe. If France or Germany run up a whopping deficit, the franc or the mark would collapse. But if the U.S. runs up a huge deficit, that deficit is "monetized" and the resulting paper is used as additional U.S. purchasing power.

There is much in the news to suggest that Europe is at the point of balking at current U.S. monetary policies (see news clip). The trend of the U.S. balance-of-payments and the prospect of unprecedented U.S. budgetary deficits is causing great concern among U.S. creditors. Last week golds, particularly the South African golds, moved up sharply. Rumors about gold filled almost every financial publication. "Something was in the wind." The forces which havebeen contained these many years were threatening to break out in the open again.

I have included a special piece on gold in this Letter. It was written by Michael Holzman, a brilliant student of economics who has been working closely with me over the past year. Mr. Holzman has the happy faculty of taking a difficult subject and presenting it so that it appears "easy". I believe all subscribers should study his article carefully. It deals with events and possibilities which are calculated to affect all of us in the months ahead (see special page 5).

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(Continued from page 3): The 40-Bond Average reflected the major bull market in bonds which started in 1921 and lasted until 1946. Despite the severe selling which occurred in bonds during 1930 to 1932, the 40-Bond Average snapped back and by 1936 it had risen to a new high above the 1929 peak. It took Industrials until 1954 to accomplish the same thing.

A major bear market in bonds began in 1946, and it has carried through until today. Note the weak little rally in the 40-Bonds since the 1966 lows, a rally which fails by a substantial margin to recover even half of the 1966 losses.

:SDAY, APRIL 19, 1967·

COMMON MARKET MOVES TO THWART U.S. MONETARY BID

French Win West German Support in Drive to Delay Basic World Reforms

By CLYDE H. FARNSWORTH
Special to The New York Times

MUNICH, Germany, April 18 — The Common Market's finance ministers glossed over some of their differences to reach a patchy agreement today on the stand they will take in the debate over expansion of the world's financial resources.

The ministers later offered varying interpretations as to what exactly had been accomplished. But there was almost complete agreement that the major result would be to delay basic changes in the world monetary system.

This would represent a setback for the United States, which had hoped for a broad international agreement on basic changes by the September meeting of the International Monetary Fund, and a tactical victory for France, which has been fighting the American proposals tooth and

Thus, from the standpoint of the big picture, I see the current situation as not unlike 1929 in form. This does not, of course, suggest that I believe that we are going into a collapse in business and the market on the scale of the 1930's. But it does indicate that I do not think this is a time for complacency. I believe we are witnessing a strong retracement within the context of a major (primary) bear market. Because the bear market is now in its second and most deceptive phase, I would guess that losses, substantial and agonizing losses, lay ahead for the majority of stockholders. Bear markets are calculated to separate men from their assets. Bear markets generally begin with "informed" liquidation. But they end with broad liquidation by both the informed and the ignorant. Few people can "buck the market" during the full course of a primary bear market. Any earlier "winnings" are most apt to go back to the bear in the form of tragic losses. Bear markets live on misguided hopes and the greed of amateurs and professionals. My advice is "Don't fight the bear. He has the forces of the primary trend with him, and he is probably going to claw you badly if you don't take him seriously."

The long-term chart on page 3 takes on special historical significance this week. As noted by my friend Paul Dysart (Trendway Advisory Service), this Friday, April 28, marks exactly 25 years since the famous 92.92 low close of 1942. That was the lowest Industrial low following the 1929-32 bear market, and the market has never been back to that level since. In fact, there has never been a major bear market in the 1929-32 or 1937-38 sense of the word since then. How did the U.S. succeed in running a quarter of a century without a correction of more than 27%? Perhaps it was achieved by sacrificing the nation's currency. In that quarter of a century the biggest gold stockpile the world has ever known has been dissipated to such an extent that the year 1967 may find the dollar a fiat or paper currency (no gold backing whatever).

"WHAT HAVE YOU DONE FOR YOUR GOVERNMENT TODAY?" DEPARTMENT: I thought the accompanying little clip from this week's Newsweek was amusing. In World War II they never bugged us about "Buy American" and balance-of-payments. But our Government thinks of everything now. Is it any wonder our kids are turning to psychodelic drugs? Who knows what "far out" is these days.

Autosuggestion in Saigon

The Armed Forces Radio network in Vietnam now urges each serviceman to set aside $250 of his combat pay for a down payment on a new car that will be delivered to his home when his tour of duty ends. The plugs for Detroit's automakers are part of a "Buy American" campaign being pushed by the network to keep GI's from spending sprees in Saigon and on R and R leaves. No auto brand names are mentioned—that would be illegal—but dealer representatives are on hand in the major post exchanges to accept the down payments.

MONEY AND THE ECONOMY by Michael Holzman

For this observer the most interesting news from Washington (or anywhere else for that matter) during the last week has been the intricate dance that the Treasury, Federal Reserve Board, major banks, and the Administration have been performing regarding the gold question. First the Treasury executed a brilliant, warlike step, threatening Europe with the blame for America's economic problems. Then Chairman Martin was reappointed in a beautiful series of symbolic passes, representing a "return to conservative principles" by the administration. Peterson, of the Bank of America, and Rockefeller, of the Chase Manhattan, performed a most interesting pas de deux showing their recommendation that a gold embargo be set up. Then, in a most complicated succession of passes and steps, the Administration at once denied and affirmed all the proceeding. It was a breath-taking performance.

So the government is "experimenting" with gold and the currency. Perhaps they will stop paying out gold on demand to foreign holders of dollars. Perhaps they will repeal the law that has the Treasury back twenty-five percent of the dollars in circulation with gold. In either case we will have in theory what we have long had in practice; fiat currency.

It is the opinion of this writer that the government should seriously consider the implications of any tampering with what is left of the gold standard. The New Economists believe that the linkage of money and gold is both artificial and archaic, and that a truly modern economy would operate on credit cards or some circular system of checks against demand deposits formed of other checks. This may be true, and in some totally sanitary and inhuman future this system might work. Fortunately, we are not at such a stage, and are still dealing with people. This is where the calculations of the Neo-Keynsians break down.

The gold problem is not strictly an economic or even a monetary problem. As far as the abstract workings of economics are concerned, gold has nothing to do with money. Currency that is unredeemable (can not be turned in for gold) is money as a matter of trust, the trust that the public has in the solvency and good faith of one another and of the government. It does not matter at all that one quarter or one half of all or none of this currency is in some way "backed" by gold held in government vaults, so long as that gold is not to be had in exchange for currency. Currency is worth its face value until the public no longer trusts the government. Then it is worthless, and all the gold in all the most carefully guarded vaults will not save it. On that day we will be trading in tomatoes and radishes, and money will not re-appear until trust also appears.

This system of partially packed, unredeemable paper currency, with the backing gradually decreasing in magnitude, is a testament of radical faith by the Treasury, faith that the public will either know that money is worth what it is accepted to be worth (if A gives B two loaves of bread for a dollar bill, that dollar bill is worth two loaves of bread to B and that bread is worth a dollar bill to A) or that the public will leave the matter unexamined, believing on some pre-rational level that a dollar bill is somehow transformed labor or transubstantiated produce. As soon as the second group lose their simple faith and want actual tomatoes for their labor, then all the logic of the wise and all the pleas of the Treasury will not save the dollar.

To return to the present situation, it is fortunate for the Europeans (and the wealthier Asiatics) that the government of the United States will give them gold for their dollars. As I noted above, for the student of abstract economics, this is just a curious and quaint custom left over from an earlier, less sophisticated age. He would insist: "A dollar buys a dollar's worth of goods, there is no point in carrying around gold." No point at all, unless each year a dollar's worth of goods weighs less, and unless it seems possible that the United States will stop giving gold for their shrinking dollars, and unless, at the same time, it seems likely that the price of gold (in dollars) will greatly increase in the immediate future. This is the present situation.

I think it likely, this being the case, that the average citizen of Zurich or Hamburg or Hong Kong who has a few thousand American dollars might find it best to have gold instead. Now, there are very many of these gentlemen around. And together they own many millions of dollars. And they all want to be safe. They want to know that their money will not gradually dribble away. When they become frightened, they turn their dollars in for gold. When they all become frightened at once, most of the gold in America goes to Zurich and Hamburg and Hong Kong. Then, those foreign gentlemen (and banks and governments) who did not sell their dollars for gold before America either ran out of gold or stopped selling it, will want to sell their dollars for some hard currency, say francs, at a loss, if necessary. Until this point, it has been true that a dollar is worth what the government believes it should be worth, but when foreign holders of dollars begin to sell at a loss, the value of the dollar begins to fall; slowly at first, then faster and faster.

Within America, the disappearance of gold from the government's vaults will not affect anything until the public begins to grow uneasy about plunging exchange rates. Perhaps they will decide that the foreigners are right and that the dollar is no longer worth two loaves of bread. Then they will want to turn in their dollars for goods before everyone notices and prices rise. But this very eagerness to buy goods in place of dollars will send prices up, until it takes two dollars to buy what one would before, then three, then four.

This is inflation of unbacked currency. It has no limit, and will continue until confidence is restored. "But all this is absurd," says the New Economics, "A dollar is a dollar's worth of purchasing power. It makes no difference whether it is represented by dollar bills or gold ingots." That is quite true, but only as long as everyone who holds dollars believes that everyone else will accept them at face value. As soon as confidence is sufficiently shaken, for instance, by the implementation of a gold embargo or the removal of the 25% gold clause, then it is no longer true, and the value of the dollar will begin to fall. The implications of this, and of what will be done to stop it, will be worked out in a future Letter.